

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BECKLEY STATION	)	
DISPOSAL SYSTEM, INC. FOR AN	)	
ADJUSTMENT OF RATES PURSUANT TO THE	)	CASE NO. 93-444
ALTERNATIVE RATE FILING PROCEDURE	)	
FOR SMALL UTILITIES	)	

O R D E R

On November 29, 1993, Beckley Station Disposal System, Inc. ("Beckley Station") filed its application for Commission approval of proposed sewer rates. Commission Staff, having performed a limited financial review of Beckley Station's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 3rd day of May, 1994.

ATTEST:

  
Executive Director

PUBLIC SERVICE COMMISSION

  
For the Commission

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BECKLEY )  
STATION DISPOSAL SYSTEM, INC. )  
FOR A RATE ADJUSTMENT PURSUANT ) CASE NO. 93-444  
TO THE ALTERNATIVE RATE FILING )  
PROCEDURE FOR SMALL UTILITIES )

STAFF REPORT

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STAFF REPORT  
ON  
BECKLEY STATION DISPOSAL SYSTEM, INC.  
CASE NO. 93-444

A. Preface

On November 29, 1993, the Beckley Station Disposal System, Inc. ("Beckley Station") filed its application seeking to increase its rates pursuant to the Alternative Rate Filing Procedure for Small Utilities. Beckley Station's proposed rates would produce an increase in its annual revenues of \$144,499, an increase of 90.78 percent over test-period normalized revenues from rates of \$159,180.

In Order to evaluate the requested increase, the Commission Staff ("Staff") performed a limited financial review of Beckley Station's operations for the test-period, the calendar year ending December 31, 1992. Mark Frost of the Commission's Division of Financial Analysis performed the limited review on February 1, 2, and 10, 1994 and March 1, 1994.

Mr. Frost is responsible for the preparation of this Staff Report except for Section B, Operating Revenue; Section D, Rate Design; and Appendix A, which were prepared by Brent Kirtley of the Commission's Division of Rates and Research. Based on the findings contained in this report, Staff recommends that Beckley Station be allowed to increase its revenues from rates by \$118,180.

Scope

The scope of the review was limited to obtaining information to determine whether the test-period operating revenues and

expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

## B. Analysis of Operating Revenues and Expenses

### Operating Revenues

Beckley Station reported test-period revenue from rates of \$141,569 in its 1992 annual report. Staff review of Beckley Station's information resulted in a \$17,611 normalized growth adjustment for customers added after 1992. Therefore, for the purpose of this Staff Report, total normalized operating revenue shall be considered to be \$159,180.

### Operating Expenses

In its application Beckley Station reported actual and pro forma test period operating expenses of \$223,343 and \$230,000, respectively. The following are Staff's recommended adjustments to Beckley Station's test period operations and discussions of Beckley Station's pro forma adjustments:

Sludge Hauling: Beckley Station proposed a pro forma level of sludge hauling expense of \$8,000, an increase of \$4,408 above its reported test period level of \$3,592. In the first 9 months of 1993 Beckley Station had 7.5 loads of sludge hauled at a cost of \$800

per load. On an annual basis this would result in 10 loads<sup>1</sup> of sludge and cost \$8,000.<sup>2</sup>

A review of the B&H Septic Tank Service invoices showed that Beckley Station's actual 1992 and 1993 sludge hauling expenses were \$4,542 and \$5,037, respectively. A comparison of these two amounts indicates that the test period sludge hauling expense of \$4,542 does represent Beckley Station's normally recurring amount and therefore, the pro forma adjustment should be denied.

Staff recommends that the reported sludge hauling expense be increased by \$950 to reflect the actual 1992 cost.

Utilities: Beckley Station reported a test period utilities expense of \$31,101. An analysis of the test period invoices revealed that Beckley Station overstated electric expense by \$444. Therefore, utilities expense has been decreased by that amount.

Routine Maintenance Fee: Beckley Station proposed to eliminate the routine maintenance fee expense of \$5,500 from its test period operations. In 1993, Beckley Station hired a full-time plant operator and no longer uses an outside operating service company. Since this expense will not occur in the future, Staff recommends that Beckley Station's adjustment be accepted.

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<sup>1</sup> 7.5 Loads + 9 Months = 0.83 Loads x 12 Months = 10 Loads.

<sup>2</sup> 10 Loads x \$800 = \$8,000.

Internal Supervision: Beckley Station proposed a pro forma level of internal supervision expense of \$31,800, an increase of \$8,393 above its test period level. As previously mentioned, Beckley Station hired a full-time plant operator in 1993. This adjustments is based on Beckley Station's estimate of the cost of its full-time operator, including taxes, insurance, and benefits.

Beckley Station, and Tucker Station Disposal System, Inc. ("Tucker Station") are wholly owned subsidiaries of NTS. In 1993, NTS hired Ken Lowery to operate Beckley Station and Tucker Station at an annual salary of \$33,900. Beckley Station is allocated 75 percent or \$25,425<sup>3</sup> of Mr. Lowery's salary and the remaining \$8,475 is allocated to Tucker Station.

The rate-making criteria of "known and measurable" are used to evaluate pro forma adjustments. Since NTS hired Mr. Lowery in 1993, an adjustment to reflect his salary would meet those criteria. Beckley Station provided Staff with information regarding Mr. Lowery's employment history and the duties he is required to perform. After reviewing this information and consulting with Ghasem Pour-Ghasemi of the Commission's Engineering Division, it was determined that a treatment plant of Beckley Station's size would require the attention of a full-time operator. Therefore, it appears that Mr. Lowery's salary is reasonable.

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<sup>3</sup> \$33,900 Salary x 75% = \$25,425.

Given that Beckley Station has a 470,000 gallon per day treatment plant as compared to Tucker Station's 60,000 gallon per day plant, it is logical that Mr. Lowery would spend a considerable portion of his time at the larger plant, Beckley Station. The allocation of 75 percent, or \$25,425, to Beckley Station is reasonable and should be reflected in test period operations.

Internal supervision expense has been increased by \$2,018 to reflect the allocation of Mr. Lowery's salary.

Maintenance of Treatment and Disposal Plant: Beckley Station reported test period maintenance of treatment and disposal plant expense of \$32,780. Included in this amount is \$15,760 in payments to Andriot Davidson.

The maintenance services provided by Andriot Davidson in the test period are now performed by the full-time plant operator. Since this cost will not occur in the future, Staff recommends that maintenance of treatment and disposal plant expense be decreased by \$15,760.

Beckley Station also included \$1,002 of equipment rental from the previous year which Staff has eliminated to remove expenditures that occurred outside the test period.

Upon review of the invoices, Staff determined that the following expenditures are capital in nature:

Air Compressor	\$ 257
20 HP Pump	\$ 2,057
Grinder Pump	\$ 410

20 HP Pump	\$ 1,820
30 HP Pump	\$ 3,291
Discharge Muffler	\$ 569

After consulting with Mr. Pour-Ghasemi, it was determined that the air compressor and discharge muffler should be depreciated over 5 years, and the pumps depreciated over 3 years. Therefore, maintenance of treatment and disposal plant expense has been decreased by \$8,404 and depreciation expense increased by \$2,692.<sup>4</sup>

Maintenance of Other Plant: Beckley Station reported test period maintenance of other plant expense of \$36,348. Included in that amount is Beckley Station's test period mowing expense of \$10,591.

In the test period, Beckley Station paid J&M Lawn Service a mowing fee of \$1,377 per month. For 1994, Frank Otte Nursery, Inc. ("Frank Otte") submitted the low bid of \$250 per cutting. Frank Otte will mow Beckley Station's lot 15 times in 1994 which results in an annual mowing expense of \$3,750.<sup>5</sup>

An adjustment to reflect the 1994 mowing contract would meet the rate-making criteria of "known and measurable." After

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<sup>4</sup>	Air Compressor	\$ 257 + 5 Years =	\$ 51
	Discharge Muffler	569 + 5 Years =	114
	20 HP Pump	2,057 + 3 Years =	686
	Grinder Pump	410 + 3 Years =	137
	20 HP Pump	1,820 + 3 Years =	607
	30 HP Pump	+ 3,291 + 3 Years =	+ 1,097
	Total	<u>\$ 8,404</u>	<u>\$ 2,692</u>

<sup>5</sup> \$250 x 15 Mowings = \$3,750.



consulting with Mr. Pour-Ghasemi, it was concluded that the 1994 fee is reasonable and should be reflected in Beckley Station's test period operations. Accordingly, maintenance of other plant expense has been reduced by \$6,841.

Miscellaneous Customer Accounts: Beckley Station proposed a pro forma level of miscellaneous customer accounts expense of \$5,300, an increase of \$356 above its test period level. For the 12 month period ended September 30, 1993, Beckley Station paid an average monthly collection fee of \$444, which is the basis for its adjustment.

Beckley Station's customer billing and collection is performed by the Louisville Water Company ("Louisville"). In the test period, Beckley Station paid Louisville an average billing and collection fee of \$1.17 per customer. This average fee combined with the number of customers used to calculate normalized operating revenue results in a collection expense of \$5,735.<sup>6</sup>

An adjustment based on the actual test period billing and collection fees at the current customer level would meet the rate-making criteria of known and measurable, and is more accurate than Beckley Station's proposed adjustment. Therefore, miscellaneous customer accounts expense has been increased by \$791.

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<sup>6</sup> 817 Customers x 6 Bi-monthly Billings = 4,902 Bills.  
4,902 Bills x \$1.17 = \$5,735.

Outside Services: Beckley Station reported outside services expense of \$8,354 for the test period. Included in this amount are engineering fees of \$1,188 paid in the test period for services rendered in the previous year. Outside services expense has been reduced by \$1,188 to eliminate the engineering fees incurred outside the test period.

During the test period, Beckley Station expensed the cost to prepare a system map of \$3,159. A system map is a capital expenditure that will benefit more than one period and therefore, it should be depreciated rather than expensed. After consulting with Ghasem Pour-Ghasemi, it was determined that the system map should be depreciated over 5 years.

Outside services expense has been decreased by \$3,159 and depreciation expense increased by \$632.<sup>7</sup>

Employee Benefits: In 1993 NTS paid \$5,837<sup>8</sup> in employee pension and benefits for its plant operator, of which 75 percent or \$4,378 was allocated to Beckley Station. Staff is of the opinion that an adjustment to reflect the employee benefits would meet the criteria of known and measurable, and that the amount allocated to

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<sup>7</sup>      System Map                      \$ 3,159 + 5 Years = \$ 632.

<sup>8</sup>      Workers Compensation                      \$ 1,892  
         Health Insurance                      3,269  
         Life Insurance                      114  
         Disability                      156  
         401k Retirement Plan                      + 406  
         Total                      \$ 5,837

Beckley Station is reasonable. Therefore, operating expenses have been increased by \$4,378.

Depreciation: Beckley Station reported depreciation expense of \$52,091 for the test period. Included in this amount is depreciation for Plant #1 and Plant #2 of \$4,667 and \$4,801, respectively.

Contributions in Aid of Construction ("CIAC") are cost free capital to the utility. If depreciation expense on property funded by CIAC is included for rate-making purposes it would result in double recovery of the plant investment from the contributors, Beckley Station's ratepayers. Therefore, Staff recommends that depreciation funded by CIAC be disallowed.

Based on its review of the Commission's Order in Case No. 9039<sup>9</sup> granting Beckley Station the Certificate of Public Convenience and Necessity to build Plant #2, Staff concluded that Plant #2 was funded by CIAC. Therefore, depreciation expense has been decreased by \$4,801 to eliminate depreciation expense associated with Plant #2.

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<sup>9</sup>

Case No. 9039, Application of Beckley Station Disposal Systems, Inc., for an Order Pursuant to Chapter 278 of the Kentucky Revised Statutes for a Certificate of Public Convenience and Necessity Authorizing and Permitting Applicant to Construct an Addition to the Existing Sewage Treatment plant Serving Beckley Woods Subdivision and lake Forest Subdivision, Jefferson County, Kentucky, Order issued July 20, 1984.

Beckley Station received Commission approval to purchase the assets of Beckley Woods Sanitation Company in Case No. 8320.<sup>10</sup> In a rate case filed after the asset purchase,<sup>11</sup> it was noted that Beckley Station had reported the assets of Beckley Woods at the purchase price rather than the original cost as required by the Uniform System of Accounts for Sewer Utilities.

In that proceeding, the Commission ordered that Beckley Station make the following adjustment to utility plant in service:

Utility Plant in Service	\$ 383,314	
Retained Earnings	\$ 61,464	
Accumulated Depreciation		\$ 84,474
CIAC		\$ 360,304

According to Staff's analysis of the depreciation schedules, the adjustment was not made.

Based on the accumulated depreciation and CIAC in the above adjustment, Plant #1 has been fully depreciated for rate-making purposes. Accordingly, depreciation expense has been decreased by \$4,667 to remove the depreciation expense associated with Plant #1.

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<sup>10</sup> Case No. 8320, The Joint Application of Beckley Woods Sanitation Company and Beckley Sanitation Disposal Systems for Approval of Transfer of a Sewer Treatment Plant, Order issued December 21, 1981.

<sup>11</sup> Case No. 9541, Application of Beckley Station Disposal Systems, Inc., for an Order Pursuant to Chapter 278 of the Kentucky Revised Statutes Authorizing and Permitting an Adjustment in the Rates for the Existing Sewage Treatment Plant Serving Beckley Woods Subdivision and Lake Forest Subdivision, Jefferson County, Kentucky, Order issued September 17, 1986.

Amortization: Beckley Station indicates that it will cost \$4,800<sup>12</sup> to clean its plant holding tanks and lift stations. Because the plant holding tanks and lift stations will not be cleaned every year, Beckley Station proposed to amortize the cost over 3 years, which results in an amortization expense of \$1,600.<sup>13</sup>

After consulting with Ghasem Pour-Ghasemi, it was determined that Beckley Station's holding tanks and lift stations should be cleaned at least every 3 years and that the estimated cost is reasonable. Accordingly, amortization expense of \$1,600 has been included in test period operations.

Payroll Taxes: Based on the salary allocation determined reasonable herein, Beckley Station's pro forma payroll taxes would be \$2,113.<sup>14</sup> Accordingly, test period expenses have been increased by this amount.

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<sup>12</sup>	Plant Holding Tank	\$ 2,500
	Lift Stations: 5 Tanks x \$300 =	1,500
	Cost to Haul Sludge	+ 800
	Total	<u>\$ 4,800</u>
<sup>13</sup>	\$4,800 + 3 Years = \$1,600.	
<sup>14</sup>	FICA & Medicaid	\$25,425 x 7.65% \$ 2,593
	Federal Unemployment	64
	State Unemployment	+ 160
	Total	<u>\$ 2,113</u>

### Other Deductions

Interest Expense: Beckley Station proposed a pro forma level of interest expense of \$66,279, a decrease of \$41,646 from its test period level, to eliminate debt used for past operating expenses. Beckley Station deducted the accumulated retained earnings from total debt and added back accumulated depreciation. This was combined with the blended annual interest rate of 6.88 percent to arrive at Beckley Station's pro forma interest expense of \$66,279.

Allowing interest on debt incurred to pay for past operating expenses would constitute retroactive rate-making by requiring the current customers to pay for service provided to past customers. However, after reviewing Beckley Station's interest expense calculation, Staff concludes that it is reasonable and that it eliminates the interest on debt incurred to pay for past operating expenses. Therefore, Staff recommends that Beckley Station's adjustment be accepted.

### Operations Summary

Based on the recommendations of Staff contained in this report, Beckley Station's operating statement would appear as set forth in Appendix B to this report.

### C. Revenue Requirements Determination

The approach frequently used by this Commission to determine revenue requirements for small, privately-owned utilities is the operating ratio. This approach is used primarily when there is no

basis for rate-of-return determination or the cost of the utility has fully or largely been recovered through the receipt of contributions. Staff recommends the use of this approach in determining Beckley Station's revenue requirement.

Staff is of the opinion that an 88 percent operating ratio would allow Beckley Station sufficient revenues to cover its operating expenses, and to provide for reasonable equity growth. Staff's adjusted operations provide Beckley Station with an operating ratio of 116.69 percent.<sup>15</sup>

An operating ratio of 88 percent results in a revenue requirement of \$277,360.<sup>16</sup> Therefore, Staff recommends that Beckley Station be allowed to increase its annual operating revenues by \$118,180.<sup>17</sup>

Although Staff informed Beckley Station that allowances for state and federal income taxes are included in the revenue requirement calculation for C Corporations, it declined this treatment because of the amount of its loss carry-forwards.

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<sup>15</sup>      $\$185,751 + \$159,180 \approx 116.69\%$ .

<sup>16</sup>     Adjusted Operating Expenses                     \$ 185,751  
         Operating Ratio                                 +       88%  
         Subtotal     \$ 211,081  
         Add: Interest Expense                           +    66,279  
         Required Operating Revenue                   \$ 277,360

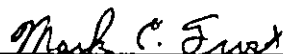
<sup>17</sup>     Required Operating Revenue                     \$ 277,360  
         Normalized Operating Revenue                - 159,180  
         Required Revenue Increase                     \$ 118,180

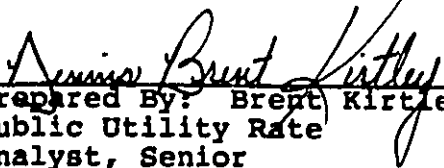
Therefore, an allowance for income taxes has not been included in the determination of Beckley Station's revenue requirement.

D. Rate Design

In its application, Beckley Station filed a schedule of present and proposed rates that did not include any changes in rate design. Staff agrees that the current rate structure should not be altered. The recommended rates will generate and satisfy the revenue requirement from rates of \$277,360. Therefore, Staff recommends the rates in Appendix A be approved for sewer service.

E. Signatures

  
Prepared By: Mark C. Frost  
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APPENDIX A

TO STAFF REPORT CASE NO. 93-444

Staff recommends the following rates be prescribed for customers of Beckley Station Disposal Systems, Inc.

<u>Classification</u>	<u>Monthly Charge</u>
Single Family Residential	\$24.05
Multi-Family Residential	18.05
All Other	24.05 Per Residential Equivalent

# APPENDIX B

TO STAFF REPORT CASE NO. 93-444

	<u>Actual Operations</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma Operations</u>
Operating Revenue:			
Flat Rate - General	<u>\$ 141,569</u>	<u>\$ 17,611</u>	<u>\$ 159,180</u>
Operating Expenses:			
Operation & Maintenance:			
Sludge Hauling	\$ 3,592	\$ 950	\$ 4,542
Utilities	31,101	< 444>	30,657
Rents	852	-0-	852
Misc. Operating Supplies	20,554	-0-	20,554
Maintenance:			
Routine Maint. Fee	5,500	< 5,500>	-0-
Internal Supervision	23,407	2,018	25,425
Treat. & Disposal Equip.	32,780	< 25,166>	7,614
Other Plant	36,348	< 6,841>	29,507
Customer Accounts	4,944	791	5,735
Office Supplies	1,038	-0-	1,038
Outside Services	8,354	< 4,347>	4,007
Insurance	804	-0-	804
Employee Benefits	-0-	4,378	4,378
Total Operation & Maint.	<u>\$ 169,274</u>	<u>\$&lt; 34,161&gt;</u>	<u>\$ 135,113</u>
Depreciation	52,091	< 6,144>	45,947
Amortization	-0-	1,600	1,600
Taxes	978	2,113	3,091
Total Operating Expenses	<u>\$ 222,343</u>	<u>\$&lt; 36,592&gt;</u>	<u>\$ 185,751</u>
Net Operating Income	<u>\$&lt; 80,774&gt;</u>	<u>\$ 54,203</u>	<u>\$&lt; 26,571&gt;</u>
Other Deductions:			
Interest Expense	<u>107,925</u>	<u>&lt; 41,646&gt;</u>	<u>66,279</u>
Net Income	<u>\$&lt;188,699&gt;</u>	<u>\$ 95,849</u>	<u>\$&lt;92,850&gt;</u>